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C O N F I D E N T I A L SECTION 01 OF 05 TEGUCIGALPA 000542

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STATE FOR WHA/CEN, WHA/EPSC AND EEB/OMA

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TAGS: ECON EFIN HO
SUBJECT: HONDURAN ECONOMY LIKELY TO LIMP THROUGH 2009

REF: A. TEGUCIGALPA 308
¶B. TEGUCIGALPA 205
¶C. TEGUCIGALPA 78
¶D. TEGUCIGALPA 69
¶E. 08 TEGUCIGALPA 1161
¶F. 08 TEGUCIGALPA 138

Classified By: Amb. Hugo Llorens, E.O. 12958, 1.4(d)

¶1. (C) Summary: Unless the current political turmoil leads to prolonged civil unrest, Honduras should be able to avoid a major economic crisis for the balance of 2009. However, recent policies, together with an unfavorable external environment, are severely constraining the options of whoever will occupy the Presidential Palace after January 2010. Economic growth has slowed dramatically over the past 18 months and will probably be negative this year. Current wage and exchange rate policies are predicted to shave further points off baseline growth over the next five years. Exports and remittances are falling. But so far foreign reserves are holding up, thanks to injections of Venezuelan cash and an even sharper contraction in imports, aided by falling fuel prices. No budget has been submitted to Congress for the fiscal year that is now half over. Short-term bonds are being used to finance an explosion in current spending. About 10 billion lempiras (USD 530 million) will need to be rolled over between October 2009 and February 2010. Barring significant policy changes over the next six months, the next government will have to adopt unpopular adjustment measures soon after assuming office. End Summary.

Growth and Inflation Trends

¶2. (SBU) Although the GOH continues to forecast 2-3 percent growth for this year, and IMF staff a more conservative 1.5 percent, evidence is mounting that the Honduran economy in 2009 will grow negligibly if at all. In fact, the higher probability is that the Honduran economy is now mired in recession. The Central Bank's April monthly index of economic activity -- a short-term proxy for GDP -- showed productive activity contracting by 2.2 percent for the first four months of the year. Declines were particularly marked in construction (-19 percent), banking and insurance (-12 percent) and manufacturing (-7 percent). Agriculture was flat. Only public administration (up 7 percent) and miscellaneous services (up 9 percent) showed significant growth. The behavior of imports and government revenue (see below) provide further evidence that the economy is in recession.

- Index of Economic Activity
- January-April 2009

Sector	Pct Chg	GDP share
Misc svcs	9.0	.22
Mfg	-6.6	.21
Commerce	-2.1	.15
Agriculture	0.7	.13
Construction	-19.3	.07
Trans/Commun	-4.0	.07
Bank/insur	-12.1	.07
Pub Admin	6.7	.06
Mining	4.1	.01
Elec/water	-4.1	.01
TOTAL	-2.2	1.00

Source: Central Bank of Honduras (BCH)

¶3. (SBU) A study financed by USAID through the Honduran Investment and Development Foundation (FIDE) estimated, by means of a computable general equilibrium (CGE) model, that the sharp increases in wages that Zelaya decreed last December (ref E), together with his insistence on keeping the lempira at the rate it was fixed at in October 2005, would reduce GDP by 4.7 percent over the next five years, as well as increase unemployment by 6.8 percent and reduce exports by 16 percent. On the other hand, the model predicted, a nominal devaluation of 4.5 percent would raise exports 10 percent within three years, restoring current account

balance, and increase GDP 2 percent.

¶4. (U) On the plus side, the sharp drop in fuel prices and more modest declines in global grain prices has caused consumer price inflation to ebb significantly. Consumer prices through May increased at a 2.6 percent annual rate, compared with 10.8 percent annual inflation in 2008.

Employment

¶5. (U) The Honduran Manufacturers Association, which represents employers in the export-processing ("maquila") industries, has reported 30,000 layoffs since last August due primarily to declining U.S. demand for Honduran-made apparel and auto parts. The pre-crisis maquila employment level was about 140,000. The Honduran Private Enterprise Council (COHEP) -- an umbrella organization representing a broad swath of mostly larger and medium-sized employers -- claims 180,000 jobs have been lost throughout the economy in recent months, in large part a result of Zelaya's decision to raise the minimum wage 60 percent in January (ref E). However, this claim is impossible to verify, because the GOH reports employment data only once a year, based on a household survey conducted in May. The May 2009 survey will not likely be published until late this year. Total employment was estimated at 2.9 million in May 2008. So a loss of 180,000 jobs would constitute 6.2 percent of the employed workforce.

¶6. (SBU) The May 2008 survey estimated unemployment was 3 percent. Post considers this figure to be deceptively low because those who cannot find jobs in Honduras typically emigrate to the United States and thus are not counted in the surveys. That said, if the COHEP claim of 180,000 job losses is accurate, the current unemployment rate would be around 9 percent. The May 2008 survey also showed a third of the workforce was underemployed. Meanwhile, it appears the emigration safety valve may be closing. Deportations of Hondurans from the United States are down 5 percent compared with last year -- an indicator that fewer Hondurans are attempting to enter illegally because U.S. job opportunities are drying up.

Exports and Balance of Payments

¶7. (U) Honduran exports, especially of maquila goods, have been weakening since the middle of 2008, although not as drastically as for some other countries. Apparel exports to the United States, the largest single category of Honduran exports, were off 20 percent January-April compared with the same period of 2008. Exports of automobile wire harnesses, the second most important maquila good, were down 44 percent, due to weakness at customers Ford, GM and Chrysler. Coffee exports were down 21.4 percent due to a decline in volume and a 14 percent drop in average prices in the first quarter. Bananas were down 26.7 percent, despite stable prices. In contrast, melon exports were up, thanks to the lifting of the import alert against a Honduran melon farm for salmonella contamination. The Honduran Central Bank (BCH) reports total exports of "general merchandise" (excluding maquila goods, which constitute about half of Honduran exports) were down 12.6 percent to USD 890 million.

- Trend of Major Exports
- January-April
- (million USD)

Product	2008	2009	Pct Chg
Apparel(1)	791	633	-20
Wire harnesses(1)	111	63	-44
Coffee	318	250	-21
Bananas	121	89	-27
Melons	31	35	13
Palm oil	48	25	-48
Vegetables	26	21	-21
Tilapia	21	19	-8

Sources: USITC, Central Bank of Honduras (BCH)
(1): to U.S. only

¶8. (U) Imports, meanwhile, were down even more sharply, causing the merchandise trade deficit to narrow. This was in large part due to a sharp decline in the prices of imported fuels (Honduras imports 100 percent of its hydrocarbons). The average fuel import price index for January-April was down 48.5 percent compared with a year earlier. Thus the value of imported fuel was down 41.2 percent despite a 7.5-percent increase in volume. Non-fuel imports, however, were also down significantly -- by 16.1 percent. Total imports declined 21.3 percent to USD 2,143 million, according to BCH.

¶9. (U) Remittances, which have equaled about a fifth of GDP in recent years and have played a significant role in sustaining both the current account and domestic demand, slowed throughout 2008 and began declining in early 2009. Through May, remittances are down 6.5 percent year-on-year to USD 1,020 million, according to BCH.

- Balance of Payments Indicators
- January-May
- (million USD)

-	2008	2009	Pct Chg
Exports	1,409	1,209	-14
goods	1,080	897	-17
services	329	312	-5
Imports	3,392	2,949	-13

goods	3,098	2,739	-12
services	294	210	-29
Remittances	1,092	1,020	-7
TOTAL	-891	-720	19

Source: BCH Foreign Exchange Balance report
(Note: these data reflect foreign exchange transactions reported by banks and therefore differ from customs data on the value of goods entering and leaving the country; they nonetheless provide a useful short-term proxy for current account trends)

¶10. (U) Tourism revenue was off nearly 18 percent January-May to USD 139 million. But expenditure by Honduran travelers abroad was down 45 percent to USD 115 million, so the services balance improved. It is now being projected that the current account deficit in 2009 will shrink to about 8 percent of GDP -- still dangerously high but an improvement over last year's 14 percent.

¶11. (U) The inflow of private capital January-May was off 11.7 percent compared with 2008 to USD 491.3 million, according to BCH. This was a relatively modest drop considering that the Institute for International Finance is projecting total FDI flows to developing countries this year will drop by more than half. More recently, however, there is considerable anecdotal evidence that major investment plans are being postponed or canceled because of political uncertainty and declining competitiveness resulting from Zelaya's wage and exchange rate policies.

Venezuela to the Rescue?

¶12. (SBU) Over the past year and a half Zelaya's team appeared to be betting that financial support from Venezuela through ALBA and Petrocaribe would offset declining private investment flows and budget support from other donors. Venezuela has in fact provided about USD 175 million in concessional long-term financing over the past several months, which has helped keep foreign exchange reserves stable at around USD 2.45 billion -- roughly four months of imports (reserves did fall by about USD 50 million in June, according to BCH website). However, much of this consisted of one-time contributions, and there is no guarantee that this level of support will continue, even if Zelaya is returned to power.

¶13. (SBU) The major source of Venezuelan support is

Petrocaribe, through which Honduras received about 3.3 million barrels of Venezuelan petroleum products valued at USD 218.4 million between June 2008 and April 2009, according to the Honduran Petroleum Administrative Committee (CAP). Of this total, about 43 percent was provided on credit, with payment terms of up to 25 years, with a two-year grace, at 1-percent interest. The rest was to be paid in cash within 90 days of receipt. Honduras has thus received about USD 94.2 million in long-term soft financing through Petrocaribe as of the end of April. However, because of declining prices for the products provided, only USD 34.5 million of that was received in 2009, and the portion provided on credit has shrunk from 48 percent in 2008 to 36 percent in 2009. BCH reported it had USD 126.1 million on deposit from Petrocaribe proceeds as of April 30. But part of that represented balances that were subject to 90-day repayment.

¶14. (U) Under the August 2008 agreements through which Honduras acceded to the Venezuelan-led Bolivarian Alternative for the Americas (ALBA), Venezuela was to purchase USD 100 million worth of GOH bonds, with the proceeds to be used for

low-income housing, and provide an additional USD 30 million to support agricultural development loans through the Honduran Agricultural Development Bank (Banadesa). Embassy sources report the USD 30 million is sitting in the Central Bank, together with USD 50 million of the promised USD 100 million in housing bond proceeds. At the moment these funds constitute part of the BCH's foreign reserves. But once trust funds and mechanisms are established for their disbursement, they will be put into circulation. Other than the remaining USD 50 million for the housing bonds, there are no other existing Venezuelan financing commitments to Honduras under ALBA.

¶15. (U) A Petroalimentos fund established in August 2008 for Petrocaribe-participating countries is dormant, because it was to be supported with a 50-cent contribution from each barrel of Venezuelan petroleum exported at prices above USD ¶100.

Fiscal Situation

¶16. (SBU) Zelaya was removed from office in a coup six months into the fiscal year without having submitted a 2009 budget to Congress. Zelaya and his finance minister, Rebeca Santos, who has also been deposed, asserted the authority to continue to operate on the basis of the 2008 budget. However, the independent fiscal watchdog group FOSDEH estimates the GOH is in fact spending at a rate roughly 13 percent above 2008 levels, and spending in 2009 will reach 69 billion lempiras (USD 3.65 billion, or 25 percent of GDP). Spending is being driven by a rising public sector wage bill. Public salaries have roughly doubled in nominal terms since Zelaya took office, and last September's decision to establish a minimum public salary of 5,500 lempiras (USD 291) a month, and to subsequently raise the statutory minimum wage to the same level (which has a ratchet effect on many public salaries) will put further pressure on the current and future budgets.

¶17. (SBU) On the revenue side, different data sources conflict, but it is apparent that tax collections are up only slightly if at all. The revenue authority (DEI) reports that income, sales, property and import taxes through May were all down compared with 2008. But DEI claims total collection was up 2.2 percent, thanks to a nearly 70 percent increase in other revenue categories, such as highway trust fund contributions. The Central Bank reports sharper declines in income and sales taxes -- a strong indicator that the economy is in recession -- and calculates total tax collection is down 1 percent.

- Tax Collections January-May
- Pct Chg from Previous Year

Tax Type	BCH	DEI	Share of total
Income	-7.3	-2.5	.33
Sales	-12.1	-8.2	.43
Import duties		-27.4	.08
Property		-38.7	.02
Other		68.6	.14
TOTAL	-1.0	2.2	1.00

Sources: BCH, Revenue Administration (DEI)
Shares based on pct of 2008 tax revenue according to DEI
¶18. (SBU) FOSDEH reports that the central government budget deficit for the first quarter of 2009 was slightly more than 2 billion lempiras (USD 106 million). It says the Economist in a May country report estimated the deficit for the year would come to 3.5 percent of GDP, compared with 2.3 percent

in 2008. BCH reported the domestic debt of the consolidated public sector at the end of April was 10.49 billion lempiras (USD 664 million), up nearly 20 percent from a year earlier. This is not large in relation to GDP, but the bulk of it is short-term and will need to be rolled over within a year. The GOH has already placed 3 billion lempiras (USD 159 million) in short-term notes this year, which will come due February 3, 2010 -- one week after the end of Zelaya's constitutional term. It plans to finance the balance of its shortfall this year by means of a bridge loan from the Central Bank, which by law may not extend beyond December 31. In addition, 3.5 billion lempiras (USD 185 million) of older bonds will come due in the fourth quarter of 2009. Taken together, this implies that the GOH will need to roll over roughly 10 billion lempiras (USD 530 million) of domestic debt -- an unprecedented amount -- between October 2009 and February 2010.

¶19. (U) The external debt of the public sector at the end of April was up 18 percent from a year earlier, to USD 2.25 billion. But the debt/GDP ratio remains comfortably low, about 16 percent, thanks to roughly USD 4 billion of bilateral and multilateral debt forgiveness between 2004 and ¶2007.

Comment

¶20. (C) Barring major civil disorder in the second half of this year, Honduras should be able to escape an economic collapse. Fiscal trends are disquieting, but debt and deficit levels are not in the critical range. The current account deficit is shrinking, thanks to the recession and lower fuel prices. Unemployment is rising but is not yet leading to significant social unrest. Of more concern for the country's medium-term economic outlook is the ongoing constitutional crisis. Business contacts report that investment has all but come to a halt over the past two months. There is annecdotal evidence that production is shifting from Honduras to Mexico and to neighboring Central American countries for a combination of perceived rising political risk and loss of competitiveness for wage and exchange rate reasons. Maquila producers told EconCouns in late May that their major concern was no longer the U.S. recession, which they see coming to an end, but the political situation. Many business leaders are now applauding Zelaya's removal from office in a June 28 coup. But this extra-constitutional move may actually hamper economic recovery by undermining rule of law and deterring investment. End Comment.
LLORENS